



Residential Real Estate Project Finance

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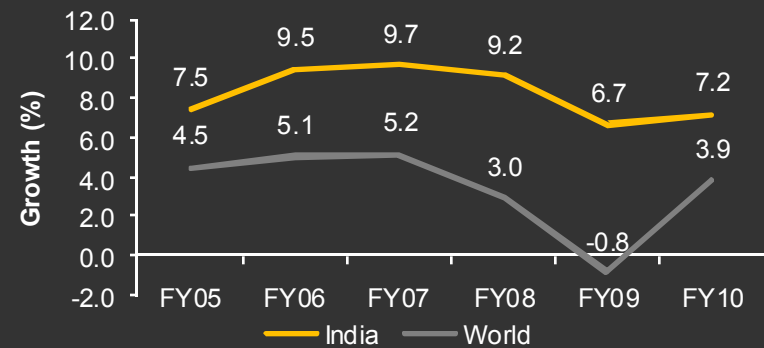
India growth story

- ▶ Driven by sustained reforms since 1991, India has transformed from a slow-growing and closed economy to a fast-growing and open economy.

After decades of low growth, the economy has moved into a high-growth phase

- ▶ **Average GDP growth of 8.5%** during FY05-09, second only to China's among the world's emerging economies
- ▶ **Largest exporter of IT services** in the world with an estimated market share of 55%
- ▶ Transformation from a **rural economy to services economy**
- ▶ Significant increase in India's foreign exchange reserves from USD5.8 billion at the end of March 1991 to **USD279 billion as on 23 April 2010**

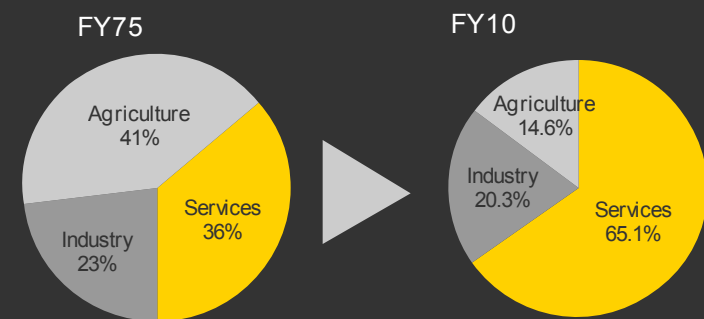
GDP growth: India vs. World (%)



Per capita GDP growth



Sectoral Share of GDP



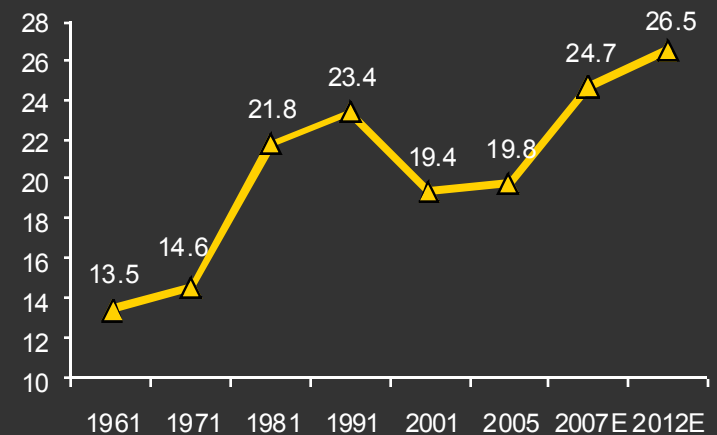
Indian residential real estate market: overview



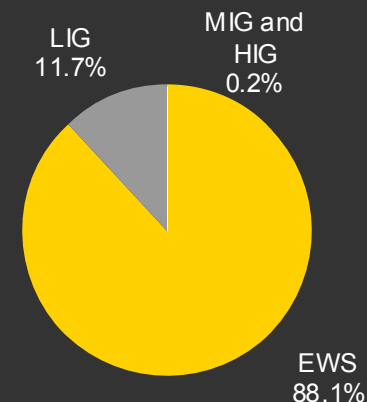
Significant demand in the residential real estate market in India...

- ▶ India's ever-increasing population has made housing a necessity.
- ▶ The residential segment makes up the bulk of the real estate industry in the country.
- ▶ According to the Eleventh Five Year Plan (2007–2012), in 2007, the housing shortage in
 - ▶ Urban areas was estimated to be 24.7 million units, of which over 88% was in the economically weaker section (EWS),
 - ▶ Rural areas was estimated to be 47.4 million units.
- ▶ This shortage (including the backlog) is expected to increase to 26.53 million during the plan period.
- ▶ Over the years, this demand-supply gap led to an escalation in residential prices in almost all cities.

Estimated housing shortage (in million)



Estimated housing shortage by category (2007)



...driven by favorable demographics and rising income

Favorable demographics

- ▶ Young working age (15-59 years) population is expected to grow from 593 million (57.7% of total population) in 2001 to 859 million in 2021 (64.2% of total population).
- ▶ Increase in number of households due to growing popularity of nuclear families.
- ▶ Number of first-time home buyers has increased significantly.

Increasing urbanization

- ▶ Degree of urbanization (%): 27.8 (2001), 28.9 (2006) and 32.1 (2020)
- ▶ Cities with population > 1 million: 23 (1991), 35 (2001) and 58 by 2020

Rising incomes

- ▶ Per capita income has increased from INR29,745 in FY05 to INR40,745 in FY10.
- ▶ No. of middle class households and rich households growing at CAGR of 14% and 21% respectively

Availability of home loans

- ▶ Mortgage finance has become easily available and borrower-friendly.
- ▶ Longer loan tenures and higher loan-to-value ratios have helped increase the disbursements from INR191 billion in FY01 to INR2,632 billion in FY09.
- ▶ Despite this growth, mortgage finance as a percentage of GDP is only 7% in India, significantly lower than that in other economies.

Affordable housing has become a priority for both the government and the developers

- ▶ Government has evolved into an enabler for housing from being a provider.
- ▶ “Affordable housing for all” is the primary objective.
- ▶ In line with this objective, a task force on affordable housing, headed by Mr Deepak Parekh, the Chairman of HDFC, was set up in January 2008.
- ▶ In December 2008, the task force (DPC) submitted its report to the Ministry of Housing.
- ▶ The government has also announced lower interest rate for home loans up to INR2 million.



- ▶ Developers have launched various affordable housing projects, mostly in the suburbs of larger cities and Tier I and II cities.
- ▶ Sizes of apartments have been reduced to make them more affordable. One-bedroom flats and studio apartments have also been launched.
- ▶ Additional features such as swimming pools and club facilities are no longer part of most projects.

Affordable housing as defined by DPC

Parameters	EWS/LIG	MIG
Size	300–600 sq ft carpet area	Not exceeding 1,200 sq ft carpet area
Cost	Not exceeding 4 times household gross annual income	Not exceeding 5 times household gross annual income
EMI/rent	Not exceeding 30% of gross monthly income	Not exceeding 40% of gross monthly income

According to the estimates of the task force, mitigating urban housing shortage could have a positive impact on the GDP growth rate of the country, which could increase by at least 1–1.5%.

Integrated townships have gained popularity

Integrated townships

- ▶ Integrated townships are self-contained townships wherein residential, commercial and retail zones are all within the same development area
- ▶ These projects have gained popularity as they provide value for money and better lifestyle to consumers and enable the “walk-to-work” environment by providing residential areas and other facilities close to workplaces.
- ▶ As for the developers, these projects allow them to diversify their risks and garner higher margins, as well as access ECB, which helps in project financing.

Project financing



Project financing – major sources (cont'd.)

Debt

- ▶ Bank credit
- ▶ External commercial borrowings

Equity

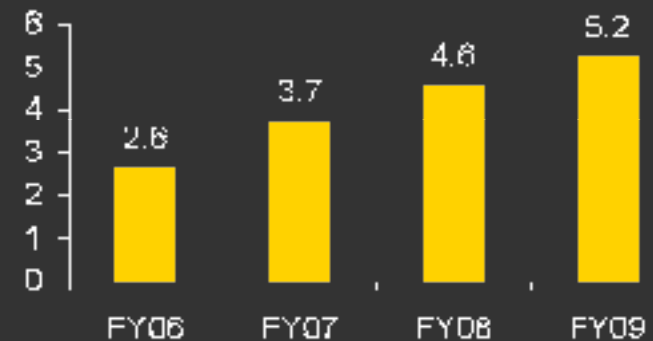
- ▶ Private equity
 - ▶ Foreign direct investment
 - ▶ Initial public offering
-
- ▶ Qualified institutional placement

Project financing – major sources (cont'd.)

▶ Bank credit

- ▶ Banks showed great enthusiasm in lending to the real estate sector beginning 2005.
- ▶ Banks lend for housing finance in the following modes:
 - ▶ Direct finance: Finance provided to individuals or groups of individuals including co-operative societies
 - ▶ Indirect finance: Term loans to housing finance institutions, commercial organizations like developers, housing boards and other public housing agencies
 - ▶ Investment in bonds of NHB/HUDCO

Bank lending to real estate market
(INR trillion)



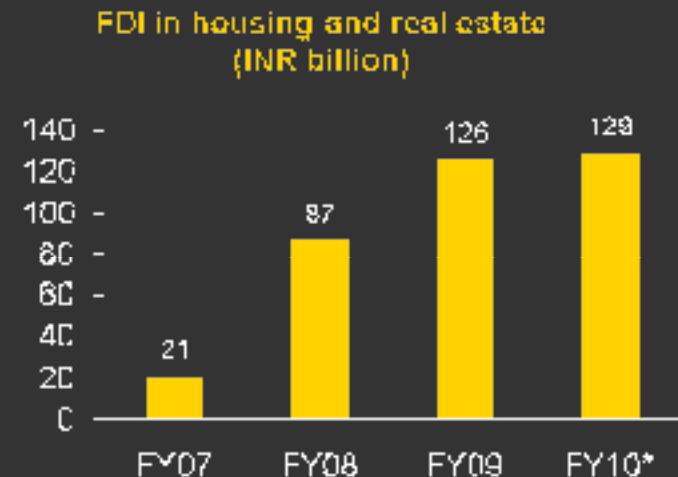
- ▶ Bank lending to the real estate sector grew by close to 15% in FY09 (Y-o-Y) to INR5,242 billion.

▶ External commercial borrowing (ECB)

- ▶ ECBs allow access to foreign money through commercial bank loans, securitized instruments, FCCBs etc.
- ▶ Since January 2009, ECB route has been opened for the development of integrated townships.

Project financing – major sources (cont'd.)

- ▶ Private equity (PE)
 - ▶ Several funds have been set up to invest in the Indian real estate in the last few years.
 - ▶ Till March 2009, the real estate sector had received around USD5.5 billion in private equity funding.
 - ▶ However, in line with the broader trend, new private equity deals announced in the real estate sector have slowed down considerably in the more recent past.
 - ▶ Moreover, the focus has now shifted to deal structures that are essentially debt but replicate an equity structure.
 - ▶ PE investors now prefer deals which are structured debt-like instruments carrying an interest income and an equity-linked component. This ensures a minimum preferred rate of return.
- ▶ Foreign direct investment (FDI)
 - ▶ The current guidelines allow up to 100% FDI through the automatic route in township, housing, built-up infrastructure and greenfield development projects.
 - ▶ FDI in India's housing and real estate sector has grown at a CAGR of 83% between FY07 and FY10, increasing from INR21 billion in FY07 to INR129 billion in FY10 (till Feb 2010).



Project financing – major sources

- ▶ Qualified institutional placement (QIP)
 - ▶ Lesser procedural requirements make this a speedier mode of raising funds.
 - ▶ QIP route offers a cost-efficient way raising funds from the domestic institutional investors, thus offering an attractive alternative during times when overseas borrowings dry up.
- ▶ Initial public offering (IPO)
 - ▶ IPOs are an attractive source to tap domestic investors as well as FII. Besides, it also offers a viable exit route to PE players.
 - ▶ Several large and mid-sized companies are expected to tap the capital markets this year.

Bank credit – regulatory aspects (cont'd.)

- ▶ Housing sector – A focus area for the regulator
 - ▶ Reserve Bank of India (RBI) has been facilitating the flow of credit to housing sector in pursuance of National Housing Policy of Central Government.
 - ▶ Therefore, ensuring an orderly growth of housing loan portfolios of banks is among the current focus areas of RBI's regulation.
 - ▶ RBI categorizes real estate industry among the sensitive sectors.
 - ▶ Exposure to housing, mortgage loans, commercial real estate is considered a part of real estate exposure.
 - ▶ RBI mandates obtaining all requisite approvals from respective authorities as a pre-disbursement condition for real estate projects.
 - ▶ As per RBI, banks can evolve their own guidelines on aspects such as security, margin, age of dwelling units, repayment schedule, etc.
 - ▶ Appraisal should be based on financial credentials/viability of the borrower on a consolidated basis at group level.

Bank credit – regulatory aspects

- ▶ Extension of credit to private builders for housing projects
 - ▶ Banks may extend credit to private builders on commercial terms by way of loans linked to each specific project.
 - ▶ Banks are not permitted to extend fund based or non-fund based facilities to private builders for acquisition of land even as part of a housing project.
 - ▶ Banks should closely monitor the projects to ensure that no part of the funds is used for any other purpose.

Real estate funding – banks' perspective (cont'd.)

- ▶ Market segmentation
 - ▶ Commercial banks have segmented the developers based on parameters such as turnover, developed area, experience, net worth, etc.
 - ▶ Based on segmentation, banks have developed customized schemes/packages for financing private builders.
- ▶ Project appraisal
 - ▶ Based on their experience, banks have developed basic appraisal standards including exposure ceilings, nature and tenor of facility, security structure, debt-equity ratio, debt service coverage ratio, security margin, etc.

Real estate funding – banks' perspective

► Project appraisal (contd.)

Loan quantum	Generally debt-equity ratio in the range of 1.25 to 1.50 (after deducting the advances from the project cost)
Facility	Working capital: for loan tenor upto 36 months Term loan: for loan tenor greater than 36 months
Basis of appraisal	Only recorded value of agreements will be the basis of cost of projects
Disbursement	Based on cash budget and actual requirement of funds
Monitoring	Close monitoring through engineers and internal mechanism

Project financing – concerns of commercial banks

- ▶ Non-availability of authentic market assessment
- ▶ Charge on the project assets – title of Land
- ▶ Delay in getting project-related approvals
- ▶ Non-adherence to stipulated norms such as FSI, land use, etc.
- ▶ Developers' reluctance for ring-fencing of the project cash flows in favor of lenders
- ▶ Market risk emerging from the fact that major part of development depends on advances
- ▶ Capability of developers in executing large-sized projects
- ▶ Concerns over RBI's new norms
 - ▶ Disclosure of mortgage bank's name in marketing material
 - ▶ Monitoring of group level exposure

Project financing – other challenges

- ▶ Non-availability of real estate investment trusts (REITs) and real estate mutual funds (REMFs)
 - ▶ The non-availability of REITs in India, which are a significant source of capital and liquidity for the real estate industry globally, has restricted retail investor participation and limited capital flows.
 - ▶ While the Securities and Exchange Board of India (SEBI) has issued the guidelines for REMFs, uncertainties over valuation and taxation have caused hindrance in their introduction in India.
- ▶ Transparency
 - ▶ Lower degree of transparency in the real estate sector needs to be addressed to improve the flow of credit.
- ▶ Challenges in foreign borrowings
 - ▶ Sources such as ECBs, being denominated in foreign currency, carry high degree of currency risks.

Way forward



Way forward

- ▶ Favorable dynamics
 - ▶ Strong market potential – growing demand
 - ▶ Government's thrust on providing housing to everyone
 - ▶ Burgeoning middle-class – higher disposable incomes
 - ▶ Further market expansion in tier-I and II cities
- ▶ Trends in housing market
 - ▶ Continued growth in affordable housing
 - ▶ Emergence of efficient building technology and cluster development approach for cost optimization
 - ▶ Restructuring of loans, selling of non-core assets and exit from non-core activities should make the businesses of developers more robust

Way forward (cont'd.)

▶ Trends in real estate finance

- ▶ Setting up of the central electronic registry (CER) by the government would help to eliminate the instances of fraud where a borrower raises multiple loans using forged documents
- ▶ Introduction of new sources of finance such as REMFs and REITs will not only contribute to the growth of the industry, but will also pave the way for small investors to participate in the growth potential
- ▶ Strategies such as syndication and collaboration will enable banks to finance large projects while limiting their risk
- ▶ Private equity investments and IPOs are likely to regain momentum

Thank you